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Supreme Court, U.S.
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No. 95-1933

In The

Supreme Court of the United States

October Term, 1995

CHARLES ROGERS, *et al.*,

Petitioners,

vs.

WALTER ROGERS, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Virginia

REPLY BRIEF FOR PETITIONERS

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14 pp

QUESTIONS PRESENTED

Whether personal property declared exempt at a certain value by operation of the United States bankruptcy law can be the subject of a subsequent state court fraudulent conveyance action filed by the same parties which failed to challenge the value or the exempt nature of such property in the United States Bankruptcy Court.

Whether the value of exempt property set by operation of the United States bankruptcy law can be challenged in a subsequent state court action by the same parties which did not challenge said value in the United States Bankruptcy Court.

ARGUMENT

Petitioners would hardly deign to further burden this Court with a reply brief except for the fact that respondents in their Brief in Opposition obscures the paramount issue arising in this appeal — the virtual destruction of a property interest arising out of and created by federal law.

Respondents initially argue that the case of *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992) does not apply due to what respondents state is an "element of purposeful concealment by the debtor at the time of the claimed exemption." Brief in Opposition, p. 9.

This Court in *Taylor*, however, prohibited any judicial review of the behavior, motives, or intent of a debtor in regard to the existence or valuation of exempt property after the Bankruptcy Rule 4003 deadline. Even if such bad faith motive existed,[1] the uncontested facts show:

(a) The entire interest/assets of petitioner NSA, Inc. was declared exempt and valued at ten dollars;

(b) The thirty-day deadline of Bankruptcy Rule 4003 upheld by this Court in *Taylor* lapsed without objection or challenge by respondents as to NSA even though respondents carefully examined Charles Rogers at the meeting of creditors;

(c) According to 11 U.S.C. § 522(l) NSA became exempt property and by operation of 11 U.S.C. § 522(c) [". . . property exempted under this section is not liable during or after the case for any debt of the debtor that arose . . . before the

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1. Which petitioners more fully refute in the attached appendix.

commencement of the case . . ."] became unavailable to a creditor for a pre-petition debt (which this was);

(d) This state court action to collect a pre-petition debt was to declare a conveyance of federally-exempt property void and subject to pre-petition collection and the state court further held that Petitioner Eleanor Rogers must pay the sum of $200,000 to the respondents as profits of NSA/ASA wrongfully obtained.

Respondents make a crucial concession — that NSA is in fact exempt — but quibble about what was exempted. Brief in Opposition, p. 8 ("[I]t is clear that in this case, the debtor claimed as exempt $10 worth of his ownership interest . . .").

Respondents further concede an ambiguity in the schedules as to what property was exempted. Brief in Opposition, p. 8 ("In the case at bar, the ambiguity in the Petitioner's bankruptcy schedule arises from his claim of a $10 exemption in a divisible asset. He . . . claims a $10 exemption in his 100% ownership.").

Thus respondents concede that Charles Rogers did attempt to exempt a 100% interest in NSA and valued that interest at ten dollars. Charles Rogers even stated in his bankruptcy petition that "Liabilities exceed assets" *See* App. to Petition for Writ of Certiorari, p. 29. I would humbly submit to this Court that there is no ambiguity and that this Court's holding in *Taylor* and the Bankruptcy Act bar collection of a pre-petition debt from federally-exempt property or even its reevaluation or reinterpretation by a state court. The state court should have enforced, not destroyed, this federal property interest.

Respondents' final argument that prior precedent of this

Court permits a state court to reexamine the value and/or exempt nature of property declared exempt from creditor action for the purpose of applying that property to a pre-petition debt in the event of actual fraud is novel but without merit. I would suggest that this argument is foreclosed by this Court in *Taylor* which stated:

> Deadlines may lead to unwelcome results, but they prompt parties to act and they produce finality.

503 U.S. at 644.

The deadline in this case produced results unwelcome to respondents but it is a final result. The exempt nature of petitioner NSA is a settled fact and the state court erred in disregarding that fact and by violating federal law. This Court must correct that error.

CONCLUSION

None of respondents' objections have any merit; the facts remain, to paraphrase John Adams, stubborn, disturbing, and largely unquestioned. While this cause is not of the same historical import as *McCulloch v. Maryland*, 17 U.S.(Wheat.) 316 (1819) or *Cooper v. Aaron*, 358 U.S. 1 (1958), the principles are largely the same — that rights created by Federal law must be upheld against state usurpation. The state trial court did not uphold the exempt nature and value of petitioner NSA which had been created and protected by Federal law. The Virginia Supreme Court upheld that erroneous decision. This is petitioners last plea — to this Court — for relief. There is nowhere else for petitioners to go. Petitioners respectfully and humbly ask this Court to protect their Federally property interests and grant this Writ of

Certiorari, reverse the judgment of the Virginia Supreme Court with instructions to dismiss this fraudulent conveyance action.

Respectfully submitted,

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APPENDIX A — EXCERPTED BRIEF FOR PETITIONER

Respondents misrepresent, in part, the grounds for the request of non-discharge. (Brief at 1). Respondents never asserted as grounds in the bankruptcy proceedings that petitioner Charles Rogers had failed to adequately explain and account for the loss of the respondents funds. Rather, respondents alleged that Charles had failed to adequately explain a loss or deficiency of assets to meet liabilities.[1]

Indeed, respondents made a diligent effort to prove that Charles could not adequately explain the large decrease in the value of NSA from $100,000+ at June 30, 1989 to $10 at June 30, 1990 and, in so doing, **conceded** that the value of NSA at June 30, 1990 was $10. (Bankruptcy Trial Transcript, June 6, 1991, 118-128). Ultimately, the Bankruptcy Court ruled that the allegation of failure to adequately explain a loss or deficiency of assets was not well-founded. (Count IV in Case No. 90-01260 and Count II in Case No. 90-01261 — Bankruptcy Court Final Order, November 9, 1991).[2]

Respondents state ". . . on July 3, 1990 Eleanor Rogers transferred the bulk of NSA assets into ASA." (Brief at 2).

Respondents omit the fact that liabilities were also transferred on July 3, 1990, and that the liabilities greatly

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1. The grounds for the request of non-discharge were: false pretenses; defalcation of a fiduciary duty; Embezzlement; fraudulent transfers of property; mutilation, falsification or failure to keep records; failure to adequately explain a loss or deficiency of assets; material omissions in bankruptcy petition and false oath. (Bankruptcy adversarial proceedings, Nos. 90-01260 and 90-01261).

2. Respondents took the position in bankruptcy court that NSA was worth no more than $10 on July 1, 1990 and elected to forego the coexisting but inconsistent remedy of an allegation of a fraudulent conveyance of NSA.

exceeded the assets. (Bankruptcy Trial Transcript, June 6, 1991 at 319 and State Court Trial Transcript, April 13, 1995 at 136).

Before Eleanor transferred the net liabilities of NSA to ASA, she obtained a $5,000 cash advance from her charge card and used the funds to capitalize ASA as part of her effort to honor the transferred liabilities. (Brief at 4a).

Respondents state "The deposit made on July 6, 1990 into ASA's account was comprised completely, of NSA gross receipts in the form of customer checks made payable to NSA." (Brief at 2).

Respondents correctly point out the composition of the July 6, 1990 deposit but misrepresent the nature of the gross receipts. Respondents represent the receipts as income/assets when, in fact, the receipts resulted in a liability because they represented prepayments for services to be provided in the future.[3]

Respondents state ". . . for the six-month period following the Transfer, NSA customer checks were consistently and exclusively deposited into ASA's account." *Id.*

Notwithstanding that a significant portion of the checks represented unearned income, respondents omit the fact that, during the time NSA checks were deposited into ASA's account, ASA was using the funds to pay down NSA liabilities.

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3. Respondents fail to acknowledge the accounting/legal principle that receipts for services are not income until the services are provided, and until such time as fees paid in advance are earned, they are to be treated as a liability. The principle that unearned income is a liability was addressed during the bankruptcy. (Bankruptcy trial transcript, June 6, 1991, at 320).

Appendix A

Respondents state ". . . of the 726 total checks deposited into the ASA account from the date of the Transfer through September of 1993, 713 of them were payable to NSA." *Id.*

Respondents omit the fact that ASA funds were, likewise, deposited into the NSA account. Also, respondents fail to disclose that certain checks payable to NSA were drawn on ASA's account and respondents ignore the fact that it makes no economic sense to examine deposits without also examining the disbursements.

On page 3 of the respondents Brief, they state ". . . following the Petitioner's . . . chp 7 bankruptcy action, the operations of NSA were simply being run through the books and records of ASA."

Respondents have lost sight of fact that Eleanor owned 100% of each corporation and considered NSA and ASA to be "brother/sister corporations" and often used one corporation to aid the other. (State Court Trial Transcript, April 11, 1995, at 85).

Moreover, examining deposits from the date of transfer through September 1993, serves no purpose as the only time period that should matter in a chapter 7 liquidation proceeding is the period up to the transfer (i.e. prior to July 1, 1990).

Respondents state "The debtor and his wife consistently stated that NSA had no value since its liabilities exceeded its assets and its assets had a value of less than $1000 . . . and . . . created the illusion that NSA had no ongoing business . . ." (Brief at 3). It was undisputed during the bankruptcy proceedings that **on the date of transfer** NSA was insolvent. (Bankruptcy Trial Transcript, June 6, 1991, 125-126, 319).

Further, it is a misstatement by respondents to imply that Charles and Eleanor stated that, post transfer, NSA had no value. On the contrary, during discovery both Charles and Eleanor revealed that NSA was an ongoing business in which Eleanor was investing her own resources. (Bankruptcy Trial Transcript, June 6, 1991, 310, 338-339 and respondents' letter to trustee, January 7, 1992, page 37 of Petition's Appendix).

Respondents state: ". . . at the time of the transfer, NSA had a valuable customer list capable of and in fact, generating a continuous stream of income. (Brief at 4). Any past customer of NSA at July 1, 1990 wouldn't have remained a customer if Eleanor hadn't invested her own resources into the enterprise in order to keep it operational. Also, the "stream of income" respondents refer too is not the consequence of a customer list, rather, it reflects payments for services rendered by Eleanor and Charles acting via the vehicle of NSA/ASA.

Respondents state that "The trial court found that at the time of transfer NSA had a substantial value, a value closer to the $294,000 figure alleged by Respondents than the $10 claimed by Petitioner". (Brief at 4).

Respondents omit the wording in the trial court's opinion that implies a finding of NSA's worthlessness, to wit: "...a simple order of reconveyance of, for instance the stock of NSA, would be a largely **empty remedy**, given the nature of the corporation and the business it conducts." Emphasis added (Judge Hamblen Letter Opinion, May 3, 1995, Rogers, et. al v. Rogers, et. al, Chancery No. 33841 at 5).[4]

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4. The trial court, in order to reach a finding of a fraudulent transfer, assigned a value of $147,000+ to NSA at the time of transfer. Conversely, the trial court, in order to justify the award of a $200,000 *in personam* judgment

(Cont'd)

Indeed, even the respondents' own valuation expert demonstrated doubt as to the value of NSA and indicated that it could be correct to consider NSA to be worthless on the date of transfer. (State Court Trial Transcript, April 12, 1995, at 65).

Contrary to the accepted asset valuation procedure in a chp 7 proceeding, the state court employed post filing hindsight and embraced a "going concern" valuation approach to arrive at a value on the date of transfer.[5]

The state court's finding of a fraudulent transfer rests squarely on its opinion of NSA's value at the time of transfer. If, as Petitioners argue, the state court's approach to estimating value is flawed, then the value arrived at by the state court is erroneous.

If, by employing the accepted balance sheet method of valuation (liquidation), NSA was worth $10 or less on the date of transfer, then, it necessarily follows, that the transfer could not have been fraudulent.

The ultimate factual issue is the valuation of NSA on June 30, 1990. Since respondents used the $10 valuation as evidence during the bankruptcy proceedings in their unsuccessful

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(Cont'd)

against Eleanor, acknowledged that because of the unique nature of the corporation, the stock may be essentially worthless. (*Id.* at 3 and 5).

5. The appropriate method of valuing property in a chapter 7 bankruptcy estate is liquidation. The bankruptcy court has defined this method of determining "value" of an asset as whether assets exceed liabilities. *Ocean Line of North Florida v. Twenty Grand Offshore, Inc.* 137 B.R. 540 (Bkrtcy, M.D. Fla. 1992).

attempt to prove that Charles could not explain NSA's decrease in value, they conceded the $10 value in the bankruptcy action. Hence, the doctrines of Collateral Estoppel and Estoppel in Pais act as a bar to the respondents' claim of a different valuation.

Respondents state "Neither Charles nor Eleanor Rogers ever disclosed the existence or operation of ASA at the Sec. 341 meeting of creditors." (Brief at 4).

Respondents mislead this Court as to the Sec. 341 meeting. Eleanor Rogers did not attend the meeting as she was not a debtor in the bankruptcy proceeding and a person cannot disclose something if they are not asked.

Respondents state that the existence or operation of ASA was not disclosed during the bankruptcy proceedings and that none of ASA's records were ever produced during the bankruptcy action. *Id.* Notwithstanding that no one asked about the existence of ASA or requested ASA's records during the bankruptcy action, ASA was not part of the bankruptcy proceedings because ASA, being solely owned by Eleanor, was not part of the bankruptcy estate.

On page 2 of their Brief, respondents state that two days **prior** to Charles' bankruptcy filing, Eleanor opened a checking account for ASA. Thereafter, respondents in their Brief attempt to equate the creation and operation of ASA to a conspiracy. Indeed, a significant portion of the state court action dealt with the pre- bankruptcy time period commencing on January 1, 1989.

This time period was extensively probed in state court despite Judge Mitchell's admonition against delving into

actions undertaken prior to the filing of the chp 7 bankruptcy petition on June 28, 1990 (Judge Mitchell's Memorandum Opinion of March 21, 1995 at 4).

In regards to the $200,000 *in personam* judgment, the trial judge treated all of the payments from NSA/ASA to Eleanor and Charles, for the 38 month period following the transfer, as income and opined that the sum represented proceeds of the assets which were fraudulently transferred.[6] (Judge Hamblen's Letter Opinion at 4).

Respondents assert that both Charles and Eleanor purposefully mislead the creditors and trustee as to any **potential** value for NSA. *Id.* On the contrary, every question posed to Charles and Eleanor was answered fully and truthfully. Even after the lengthy bankruptcy action was closed, the respondents submitted a comprehensive request to the trustee to reopen the case in order to void the transfer and recapture NSA.

The trustee, after carefully and responsibly reviewing the evidence as it related to the respondents request, declined to reopen the case. *See* Respondents' letter to trustee of January 7, 1992 and trustee's letter to respondents of February 16, 1992, shown in the Appendix to the Petition at pages 33-38 and 39-40, respectively.

Respondents state: "unknown to any of the parties in

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6. Petitioners argued unsuccessfully that since NSA was transferred during the pendency of the chp 7 bankruptcy the proceeds garnered from NSA would revert back to the Bankruptcy estate along with NSA and since assets of a bankruptcy estate are under the sole jurisdiction of the Bankruptcy court, a state court lacks the authority to decree the disposition of such assets. (Transcript of Motion For Reconsideration, June 30, 1995, 24-25).

interest and undisclosed by either the debtor or his wife . . . NSA continued to do business . . ." (Brief at 6). To the contrary, both Charles and Eleanor disclosed that NSA continued to do business after the transfer. (Bankruptcy Trial Transcript, June 6, 1991, 310, 338-339) Also, *See* Respondents' letter to trustee, January 7, 1992, at 37 of Petition's Appendix.

The bankruptcy judge, after lengthy proceedings, did not find fraud. The trustee, after an independent, post bankruptcy, investigation, did not find fraud. Only the state court concluded that the NSA transfer was fraudulent.

Respondents correctly state that Charles did not amend his homestead deed to reflect a different value beyond the $10 claimed on his bankruptcy schedules and homestead deed.

Charles did not amend his schedules and homestead deed because there was no need too. In a chapter 7, values of assets are set at the date of filing. The value of an asset at the date of filing is not determined three or five years later. Extensive post-filing hindsight is not and cannot be used in a chapter 7 liquidation bankruptcy proceeding, and any computation of value which utilizes a "going concern" approach or focuses on a speculative "potential value" is inappropriate.